

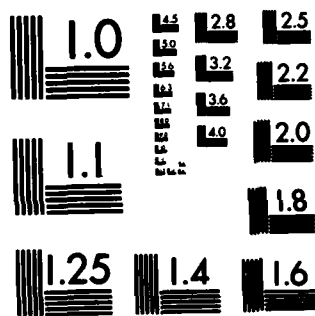
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THE POST-MUNICIPAL CITY

Anthony H. Pascal

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## I. INTRODUCTION

✓ The financing of local government is becoming increasingly problematical as the American federal system begins to negotiate the final decades of the Twentieth Century. New ways to pay for, produce and deliver the services traditionally provided by municipal government are being sought.

This paper attempts to sketch the rudiments of a new approach to local public finance. In searching for solutions it stresses the stripping away of non-essentials, the employment of market-oriented mechanisms, and the imposition of direct charges to beneficiaries. At the same time the paper seeks to deal with the equity issues posed by the suggested reforms. The ideas contained here are offered in the hope that they will stimulate a wide-ranging exchange on possible futures for the local public sector.

As a shift from the predominance of manufacturing to the primacy of service based economic activities marks the passage from the industrial to the post-industrial society, so the impending alteration in the nature of local government might be referred to as the arrival of the post-municipal city. The city of the future will look much more like a private sector firm and much less like the municipal bureaucracy we are used to seeing.

The fiscal pressures on local government. An era of fiscal restraint is upon us. Resistance to tax increases, formal fiscal controls, tax base erosion and the decline in grants from federal and state government have all contributed. The retrenchment now visible

comes after a long period of growth in the prominence of subnational government.

In 1965, the average American spent about one-seventh of personal income on state and local taxes. By 1979, that figure was almost one-fifth, an increase of more than 25 percent. Taxpayers noticed the difference. Opinion polls document the increasing disenchantment with the amount of taxes levied and the way in which they are being spent. The public registered its displeasure directly in the voting booth; by 1975, almost three-quarters of local bond and tax override elections were failing. (See Pascal and Menchik, 1980.)

Even more dramatic was the epidemic of fiscal limitations measures that has swept the country in recent years. Notable is the speedup in the adoption of financial controls on state and local government during the 1970s; 25 states joined the movement during that decade. Only 16 states remain without any limitation measure. The measures naturally vary in scope and effectiveness. Some merely constrain growth, but others such as in California, Idaho and Massachusetts significantly reduce customary levies. (See Pascal and Menchik, 1979.)

Many factors help explain the containment of government. The rapid post-war rise in tax burdens, the shift in government spending away from universalistic and toward redistributive programs, rapid inflation combined with stagnant real incomes, and rising distrust of politicians and governmental institutions have all alienated large fractions of taxpayers. The result has been a resistance to further tax increases and a tendency to vote for candidates and ballot initiatives which promise to reduce the scale of government.

The tax and expenditure limitation measures and the outflow of jobs and people from the nation's larger old cities, have recently constrained some sources of state and local revenue. Local own-source revenues (adjusted for inflation and changes in population but excluding federal grants) grew steadily during the 1960s. Their progress was much more volatile in the following decade, and since 1974 they have declined when measured in real per capita dollars to a point where they now stand below the 1969 figure. State own-source revenues peaked in 1976.

Federal grants in the last half of the 1970s accounted for about a quarter of all state and local spending. Compared to previous years, federal transfers flowed freely from 1960 to 1978. The Carter administration cut grants sharply, and, under Reagan, federal aid to state and local governments has dropped even further. Federal aid reached its peak (real per capita dollars) in 1978; since then it has fallen to about the 1974 level. Local governments have also gotten accustomed to a growing level of grants from state capitals. Between 1965 and 1975 subventions from the states supported a growing fraction of spending by cities. But as limitation measures increasingly constrain the states' own financial freedom--between 1977 and 1980, 38 states reduced taxes or adopted lids on their own taxes or expenditures--this form of assistance will dwindle. Grants from states dropped from over two-fifths of municipal own-source revenue in 1975 to about one-third in 1980 (ACIR, 1981, p. 59).

A reduced local tax base, due to social and economic changes in the city, increasingly widespread legal limits on taxes and spending, and the downward trend of grants from higher levels of government combine to

present the local policymaker with a serious dilemma. On one hand the city's diminished ability to finance services forces retrenchment. On the other there is the need to satisfy the vociferous demands of urban inhabitants. The citizens remaining in town are increasingly those most in need of public services: the old and the poor. Cities also face growing unfunded pension obligations, particularly for the uniformed services. Moreover, municipal infrastructure--roads, bridges, sewers, fire and police stations--need constant repair and renovation.

## II. REFORMING THE SERVICE FINANCE AND DELIVERY SYSTEM IN MUNICIPAL GOVERNMENT

A potential comprehensive solution, which combines a system of market-like mechanisms, is gaining increasing attention. For example public officials are awakening to the promise of pricing/rationing devices for rationalizing the provision of services with a high public good content. Recommended reforms often feature charges directly on the beneficiaries of the services cities provide. A decided advantage of user charges stems from the fact that they may be imposed on all users, even non-residents. Instead of assuming that tax and grant shortfalls should dictate reduction in scale of operations, cities are beginning to approach their citizens as potential consumers to whom they offer public services on a fee basis. But appropriate reforms go beyond the application of user charges. Below I indicate how special assessments and neighborhood-specific taxes might be employed. I also discuss departures in procedures for allocating labor and capital across service agencies and the prospects for inter-jurisdiction sales of services based on a network of jurisdictional specializations. I present some



ideas for a multi-purpose public service voucher as a means of maintaining vertical equity.

#### A. Utilizing Benefit Based Financing

User charges, fees-for-service, and special assessments are examples of benefit based financing; they hardly constitute new ideas in local finance. But some critical facts are becoming clear. First, local government people are sometimes unaware of the myriad possible applications of benefit based financing, including those applications which have proven successful in practice. Second, many officials worry about the inequitable effects of benefit based financing because they fear that switching from taxes to charges will inevitably shift the financial burden of government toward lower income groups. Third, cities often lack technical expertise to design fee schedules which reflect the often shifting cost and demand conditions that particular services operate under.

That is, officials recognize the potential of the benefit based approach for raising revenues. They are open to the argument that this approach would make government more efficient since it would encourage people to consume only as much service as they are willing to pay for. What they fail to realize is that many applications are technically feasible and that equity protections can be built into benefit based financing so as to safeguard the welfare of lower income groups.

Requiring the public to pay directly for services promises to reduce waste in consumption. In theory consumers will purchase increments to the point where marginal gains to them equal additional costs. Thus, collaterally, an important criterion governing the

employment of user charges is the ability to identify benefits and beneficiaries (see ACIR 1974, pp. 63-77). If the benefits are not visible to and largely appropriable by the potential consumer of the services, few will volunteer to pay. Trash collection then is highly amenable to financing through user charges while traffic control is not.[1]

A second choice criterion for the employment of charges as against taxes is based on the prospect for economizing behavior in the use of public resources. Services in which consumption levels are sensitive to price differentials are good candidates for the application of user charges. From this perspective parking fees may be more appropriate than sewer service charges. Ease of administration constitutes an additional selection criterion (see ACIR, 1974, pp. 63-66). The costs of monitoring production and consumption also affect the feasibility of switching to benefit-based financing. Additional obstacles to the extension of the user charge mechanism lie in the difficulty cities have in calculating price elasticities, marginal costs, and the distribution of benefits (Stocker, 1976, p. 320).

Municipalities derived one third of their own-source revenues from charges and fees in 1980, whereas in the early 1970s less than a quarter of own-source revenue was raised in this fashion. Although three-quarters of all cities claim to be making increasing use of charges and fees, those under fiscal limits have been the most avid in adopting beneficiary charges (Shannon, 1982). A majority of the public feels it is the single best way for government to raise more revenues (Shannon, 1982).

Opportunities for the establishment of user charges at the local government level occur in water distribution, education, hospitals, solid and liquid waste disposal, some aspects of fire protection, parking and road usage, recreation, and for licenses and permits. User charges can often be imposed for specific components of services which in general have a high public good content. For example, crowd control at public events or special patrols at shopping centers may be financed through user charges, while other more general aspects of police protection are financed through taxes. (See Mushkin and Bird, 1972, pp. 24-25.)

Many capital-intensive municipal services could be funded through special assessments. These are charges made by a government against a landowner for a public improvement adjacent to his property which, while generally beneficial to the community, is especially beneficial to the landowner assessed. They differ from taxes in that there is a direct relationship between the value of the benefit received and the amount of the assessment. Also unlike most taxes they are usually one-time payments. Equity protections can be integrated into special assessment financing. The collection of assessments which finance improvements redounding to the benefit of property owners (e.g., street lighting and repairs, sewer projects, etc.) could be deferred until the sale of the individual parcels so affected. (See Shoup, 1980.) Low income property owners could then vote for special assessments that generate net gains to the value of the property, but would be relieved of cash flow problems.



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Generally, the adoption of benefit based approaches need not imply the abandonment of redistributive objectives. For example, rights to consume basic levels of certain services (e.g., library privileges, emergency medical care, etc.) could be guaranteed to the poor--say by the issuance of vouchers--while other consumers would pay fees based on cost of production. Or, prices for particular services (e.g., parking charges at local parks, adult education, etc.) might vary along with the average income level of the neighborhood. To extend the applications, standard amounts of some services might be provided free of charge while consumption of additional increments would require a fee (e.g., trash collection, some social services).

Systematic thinking on this subject will generate many other promising applications for the principle. Police, fire, health, and education services are the big ticket items in local government. Paramedic services provided by the fire department would seem particularly suited to benefit based financing since consumption of this good has minimal spillover on other persons. On the other hand, it is sometimes argued that emergency medical service is a truly "free" good, at least at currently demanded levels, since it is usually provided by a corps of firefighters who need to stand by anyway. Police protection for certain properties such as warehouses, industrial parks, and shopping centers could also give rise to special charges. The technical feasibility is suggested by the frequency with which these facilities hire their own private security guards. It may even prove feasible to impose charges for emergency services on those at fault in auto and other accidents.

B. The "Essential City" vs. "The Responsive City"

The ideas contained in the market-oriented approach need to be integrated into new structures for local finance. Required is a fiscal plan for the post-municipal city. Even in the age of austerity cities will have to provide public goods to be financed out of tax revenues and whatever higher level subventions remain. But for services above the basic, bare-bones level, fees, charges, assessments, and sales comprise the best method of financing city activities. Below is laid out in a step-by-step fashion a series of reforms for the consideration of those who preside over the future of cities faced with inadequate revenues.[2] The reforms emerge from a comparison of the "essential city" and the "responsive city."

Projecting available revenues. The first task for a city contemplating fiscal shortfalls is to decide how far it can go under traditional tax financing. Forecasts of future population and pace of economic activity will permit an estimate of returns from the property tax, sales tax and other local sources. A straightforward projection of current fees would be appropriate at this juncture. Assumptions will be necessary to project future levels of grants-in-aid from higher levels of government. Complications will arise to the extent that maintenance of effort provisions affect the magnitude of categorical grants, since the coming austerity promises to reduce local tax collections. However, as the relative importance of categorical grants diminishes, this particular problem recedes over time.

Identifying essential services. The resources available from the projected revenues are not all usable for the production of services.

There are in most cities fixed charges which make first claim. Some are contractual, such as for pensions or for interest on accumulated debt. Others are constitutional, as for elections. These charges may absorb 30-40 percent of city revenues.

The next step involves the determination of what can be supported with the projected revenues minus the fixed charges. Local priorities need to be identified so as to be able to screen the traditional services for inclusion in what might be called the essential city budget. Cost for all activities so identified must then be adjusted for the effects of future inflation.

In most cities the essential budget will need to insure

- o The continuation of central administrative functions such as mayor and council, city attorney and clerk, land use control and the like.
- o The protection of life and property, including such services as fire suppression, building inspection and police response to emergencies. (Snow removal is often considered part of emergency services because it is necessary to provide access for emergency vehicles.)
- o The maintenance of core infrastructure. Although opinions will differ on frequency and quality of maintenance, some actions must be taken to sustain the continuing usability of public capital facilities.

In general, the essential services have a high content of pure public good, or are goods for which it is relatively costly to exclude those who do not pay charges. Depending on local sensibilities, the

list of essentials might also include some minimum redistributive functions as well.[3] Inevitably, the list of services to be included in the essential city will be determined in part by political factors.

#### C. Financing the Essential City

The first necessary comparison is to ascertain whether foreseeable revenues will cover the budget necessary to support the chosen list of essential services. To the extent that the revenue forecast exceeds the essential service budget, additional services could be added to the essential core.

The above calculations combine to delimit what we might call the "essential city," the basket of services which can be supported out of currently predictable taxes and grants. Beyond the levels anticipated, attempts to increase taxes are likely to lead to taxpayer resistance--as when tax overrides are defeated--or to taxpayer revolts--as when Proposition 13 or Proposition 2-1/2 is adopted. And grant levels above what are currently scheduled--perhaps even in nominal terms--do not seem likely given current attitudes in Washington and in most state capitals. For many American cities foreseeable revenues will support little more than fixed costs, stripped down central administration, hard-core protection and a low level of maintenance on roads, sewers and vital public facilities.

#### D. Organizing the Responsive City

All of the other agreeable things cities tend to do--i.e., those services with a high merit good content--will likely have to find other sources of finance. They must become part of the responsive city and cease to be part of the essential city. Parks, swimming pools, golf

courses, zoos, arts and crafts classes, after-school recreation, libraries, street sweeping, refuse collection, health clinics (except for inoculation against communicable diseases) can be financed by some combination of benefit based financing and sales to other jurisdictions.

The responsive city is to be manifested through a new public management entity I call the "revenue center." For the responsive services city agencies should behave as do private providers, selling the services they produce at prices based on long-term costs of production and the strength of local demand. The agency should be cut free of as many bureaucratic restrictions as possible so that it

- o determines its own product line
- o retains some of the net revenues (i.e., over and above cost of doing business) with which to pursue expansion or to reward particularly productive employees
- o arranges to secure inputs efficiently by hiring employees or services from the central administration or from private suppliers through contracting out.

Load shedding. The failure to encounter sufficient effective demand for a particular service would imply that the revenue center ought not to produce that service. Marginal revenues should cover marginal cost at a scale where long-run average costs are minimized. When these conditions do not occur, the revenue center must shed the load. The service may then be offered by a lower cost provider (private firm, voluntary organization, another jurisdiction) or may simply cease to be offered.



Contracting out. Revenue centers will often be able to increase their efficiency by buying rather than producing certain inputs. The term contracting out refers to the purchase of inputs by government from private sources in the process of producing a public service. The purchase typically encompasses only a component part of the whole of the service delivered to the public. Some cities, for example, contract for tree trimming in public parks or for forensic laboratory examinations in producing, respectively, recreation and police services for their residents.

Competition for city business, for which bids are often taken, is chiefly responsible for the lower cost of contracted services. Minneapolis has 50 companies competing for trash collection contracts; Wichita has 80. The cost savings can be substantial. In the early 1970s in the borough of Queens, New York publicly provided refuse collection cost \$207 per household per year, while three miles away in Bellerose, Long Island, the private costs for the same service were \$72 (U.S. News and World Report, 1975). Savas (1974, p. 109) alleges that street resurfacing under municipal auspices cost \$57 per ton of asphalt laid, while private contractors did the same job for \$20 in New York City.

Ahlbrandt (1974), in discussing contracting out argues that "the most significant long run benefits are with respect to research and development, the adoption of new technology, and the satisfaction of consumer preferences." Scottsdale, Arizona's Rural Metropolitan Fire Protection Company, for example, makes substantial use of light trucks (as compared to the heavy engines typical of municipal fire departments)

and has adopted innovative deployment strategies (U.S. News and World Report, 1975). Other services appropriate for contracting out include emergency ambulances, building security, street cleaning, snow removal, and school lunches.

Special assessments and neighborhood specific taxes. Some of the new revenue centers will rely primarily on special assessments voted by inhabitants of circumscribed subareas within the city limits. These assessments would be calibrated to reflect the increase in the value of the property attributed to the existence of the public facility or service. Thus for a park the size of the assessment might be a function of the value of the property and its distance from the park. To protect low income property owners against cash flow problems, the collection of the assessment might be deferred until the sale or transfer of the property.

For other services neighborhood specific taxes might be an effective mechanism. For the privilege of retaining a branch library reading room, residents might adopt a neighborhood head tax while circulation services could still be financed through fees. Generally, pieces of public capital which generate substantial local benefits (e.g., police station, playground, clinic) but have little effect on property values are good candidates for financing through the neighborhood head tax.

Centrally provided capital and labor services. No matter what the source of revenue the new "revenue centers" could rent or lease capital-- police cars, fire stations, parks lands--from the central administration to preserve central control of debt obligations and to give elected officials some influence over the plans of the revenue centers.

Just as the desire for accountability may work to retain the centrality of capital acquisition and control, the legal status of civil service arrangements may lead to a centralization in human resources. If revenue centers could compete for workers who hold city-wide (sometimes referred to as "wall-to-wall") rather than departmental seniority, an internal labor market would be created. Those workers not hired away by the centers but who remain in the pool provide flexibility for peak demand periods; they also call attention to what potential supervisors perceive as their low productivity. Such a scheme may increase the longer term chances of selective terminations for low productivity workers insofar as taxpayers will not long countenance the employment of persons not deemed worth putting to work in the revenue centers.

Interjurisdictional service provision. The revenue centers would not be limited to individual consumers in defining their markets. Sales of services could also be arranged with neighboring jurisdictions, special-purpose jurisdictions or higher level jurisdictions. For example

- o a central city fire agency might sell fire suppression services to surrounding suburbs
- o a recreation agency might sell leisure time instruction to the local school district
- o a zoo agency might bill the state for part support of a cultural amenity whose benefits extend well beyond the confines of its city

In these ways are economies of scale exploited to the benefit of all the taxpayers. In addition particular jurisdictions may find they have a

comparative advantage in providing particular services for reasons other than scale economies, e.g., as a result of historical factors, demography, location, etc. Encouraging inter-jurisdictional sales of services will encourage specialization and greater overall efficiency.

#### E. Equity Protection in the Responsive City

How fare low income groups in the responsive city? Without special protection they will find burdens rising as they begin to pay for the services they once received "free," i.e., those which were financed by taxes.[4] But protection devices are available. One mechanism that is particularly appealing from a philosophic standpoint--but perhaps complex administratively--is the multi-purpose public service voucher administered by a central municipal redistribution office. In this arrangement a qualified household receives the right to spend a specified sum on a wide range of public services or to pay special assessments or neighborhood taxes. The sum accorded to a particular household would be a function of its income, its size, and its nature (i.e., the presence of children, disabled, elderly, etc.). If the sum were determined to be \$1000 per year for a household with an income below \$10,000, then spending \$200 for paramedics would leave \$800 for swimming pool admissions, library privileges, special taxes to support parks and all the other things it might like to secure from public revenue centers. The household could be issued a credit card with an upper limit. The revenue center could collect from the redistribution office.

The funds to support the redistribution office come from the tax-supported general fund. In this way citizens and their elected representatives can make a deliberate choice of the level of redistribution they prefer and of the forms they would like to see it take. The service producing entities are relieved of the concern about fair access to their products; they treat all consumers equally.

Note that the above recommendations are aimed at maintaining some measure of vertical equity, i.e., equity defined in income or ability-to-pay terms. Public finance writers also discuss horizontal equity in which burdens are a function of benefits received. From the standpoint of that latter definition the shift from taxes to charges would be movement toward greater equity, prima facie.

#### F. Transition to the Responsive City

Distinguishing the essential from the responsive city and organizing the latter by means of revenue centers is a less radical notion than it might at first appear. The use of fee financing is growing apace. In California, where property taxes have been severely constrained, the use of special assessments has been expanding rapidly (Misczynski, 1982). Special funds budgeting--a halfway house to revenue centers which was stimulated by the plethora of categorical grants during the 1970s--is more and more familiar to city management. Many cities already sell services to other jurisdictions. The organization of cities into ward or councilmanic districts facilitates neighborhood level organization of service provision.

Another advantage is that the responsive city can be built gradually and deliberately. Revenue centers can be established one by one and the level of general fund tax support each receives can be reduced slowly so as to minimize disruption. Thus low demand services will not vanish overnight but will wither away as subsidies decline.

Converting city finances to benefit based, market-oriented, responsive modes is not without problems. As well as the equity complications described above there are a number of additional considerations which may prevent the easy adoption of these approaches.

Fees and charges are not deductible against federal and state income taxes as are the property or other taxes they replace. Thus there is likely to be a noticeable opposition to charges by sophisticated taxpayers. Some state constitutions and city charters constrain the use of fee mechanisms. Grant formulas by which federal and state revenues are distributed to local governments often do not include fees and charges, as they do tax supported expenditures, in the definition of local effort. New legislation would be required to deal with problems of deductibility and maintenance of effort.

Privatization and contracting out are sometimes attacked on the grounds that a shift from public to private provision means the replacement of the civil service by big business. In reality, however, the employees of the contract-securing private organizations are likely to be more modestly compensated than the civil servants they supplant. Differential employee costs in fact constitute a chief explanation of the cost reductions promised by competitive provision. The result will be more job opportunities for lower paid workers and fewer for the

higher paid, which is certainly not inequitable, however anti-union it may appear.

The organization of revenue centers as discussed in this paper will necessitate basic changes in the civil service system. Lifetime tenure within particular agencies may no longer be viable. A switch to private provision of public goods may also threaten to reverse affirmative action gains. The public sector has in the last 15 years been considerably more hospitable to minorities, employing in many large cities twice the fraction of such workers as does the general economy (see Pascal and Menchik, 1980). Although equal opportunity regulations may serve to protect the jobs of minorities (and women) already on public payrolls, new opportunities would be severely squeezed, with resultant deleterious effects on oncoming cohorts of minority workers. On the other hand, it should be possible to require appropriate equal opportunity policies among private service providers as a pre-condition to bidding on government contracts.

### III. CONCLUSIONS

The essential/responsive distinction and the employment of market-like mechanisms are growing increasingly attractive as solutions to the local fiscal crisis. The emerging fiscal plight of local government makes the timing right. The inherent philosophy appears to accord with current preferences for local self-help and private sector-style solutions to public problems. Technical assistance in implementing the concept promises something to the leaders of troubled cities at a time when direct federal financial assistance is shrinking. Obviously, instituting it will require some ingenuity and some boldness. All in

all, however, a hearty welcome for the post-municipal city seems in order.

#### NOTES

[1] All true public goods have spillover benefits. In the case of trash collection, for example, these would involve neighborhood sanitation and amenity. In general, the higher the externalities and the less the appropriability by the direct consumer, the less amenable is the service for financing and delivery by means of user charges. (For the general theory of user charges and a review of the pre-1972 literature on this topic, see Milliman, 1972.)

[2] A debt of gratitude is owed to Rand colleague Kevin Neels, who participated in the development of many of the ideas presented here.

[3] Methods for realizing income distribution objectives are discussed below.

[4] To the extent fees replace taxes which were themselves a heavy burden on the poor, such as the property tax (see De Tray, et al. 1981), the net rise in burden will be diminished. Low income families tend not to use the property tax deduction privilege in calculating income tax obligations and so would feel less pain on that score in the switch from taxes to fees (see below)

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